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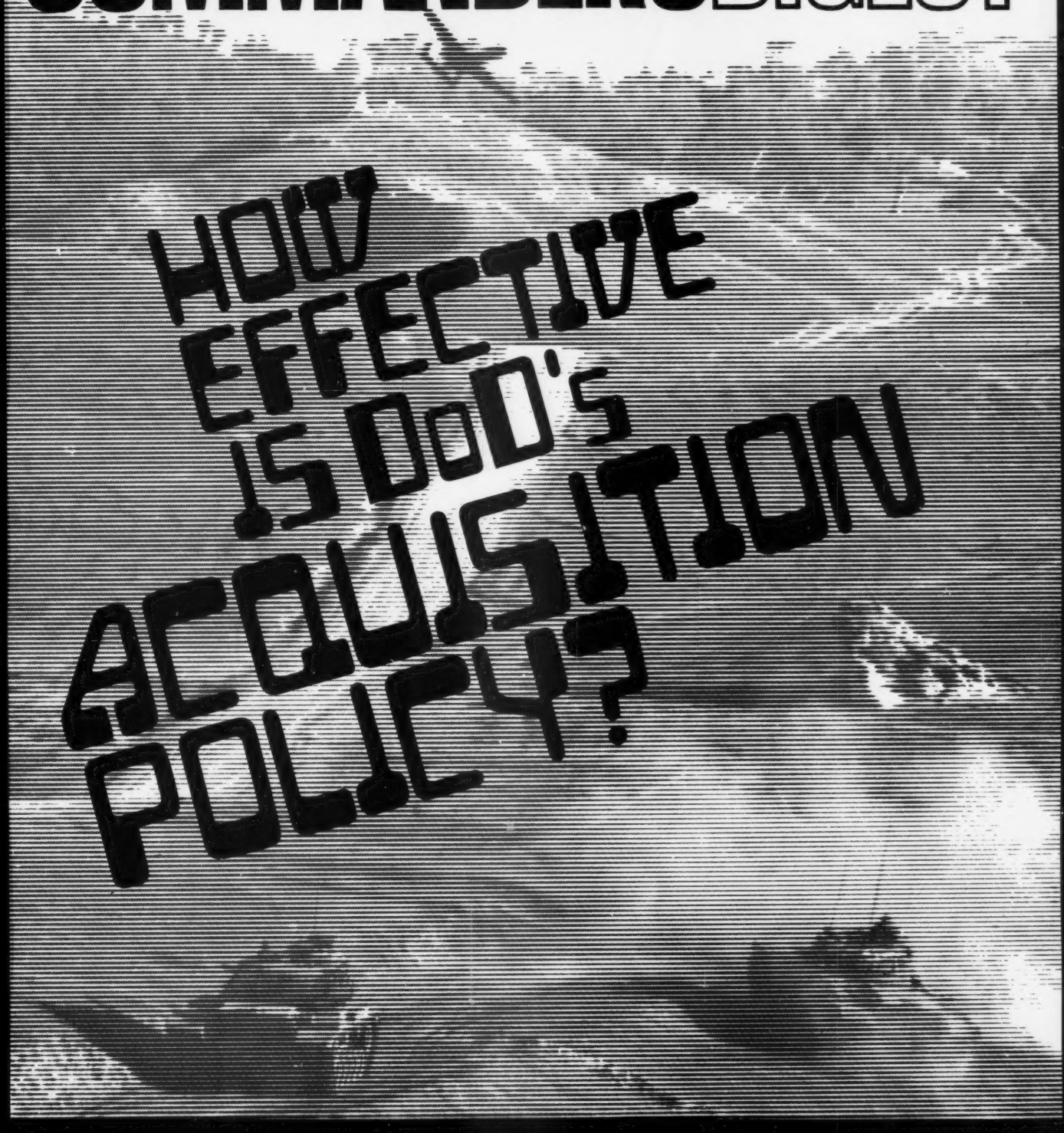
COMMANDERS DIGEST



HOW EFFECTIVE IS DOD'S ACQUISITION POLICY?

DEFENSE PROCUREMENT POLICY GOAL: MAXIMUM COMPETITION

BY DALE W. CHURCH
Deputy Under Secretary of Defense
for Research and Engineering
(Aquisition Policy)

How do the procurement policies of the Department of Defense affect the defense industrial base? This article will address those aspects of Defense procurement policies which are directed toward obtaining maximum competition in defense procurement, and how these policies are oriented toward establishing and retaining adequate sources of production for military supplies. Also touched upon are two relatively recent developments which support these efforts: Office of Management and Budget (OMB) Circular A-109 which provides Government-wide acquisition policies; and S.1264, a proposed Bill to provide one statutory authority for acquisition of all supplies and services for the Federal Government. Additionally, this article will review the manner in which DoD is implementing the recent study on capacity utilization in the aircraft industry and plans for reducing Government ownership of production plants.

Concerning the maximization of competition, no part of the Government is any more aware of the need to maximize competition than the Department of Defense. We are constantly striving to improve our track record for competitive awards. In this regard, fiscal year (FY) 1976 statistics show that including price competition, technical and design competition, and follow-on contracts where the source of supply was initially selected by competition, approximately 57 per cent of the dollars obligated were the result of competition. The other 43 per cent, in large part, represented one-source solicitations where it is more difficult to obtain effective competition. Contracts for Government-owned, contractor-operated facilities, utility services, and development and production of complex, high cost weapons systems, involving high capital investment and know-how, exemplify the types of procurement actions in this category.

MORE COMPETITION

It is in this latter area where additional competition is sought. Under OMB Circular A-109, DoD is pursuing increased competition among qualified sources in the early stages of major system acquisition. Although we can envision an expanded competitive base for design and technical competition prior to the selection of the full-scale development contractor, we also recognize the difficulty of other potential prime contractors in bidding for the system production contract. The cost experience, know-how and investment of the development contractor gives him a strong competitive edge. Notwithstanding this, we are

striving for increased competition through the high value spares breakout program, by acquiring production data packages and by assuring that the latest production know-how and technology are incorporated into the packages.

Additionally, DoD is encouraging increased prime contractor use of competition at the subcontractor levels. The approaches being explored to encourage the prime contractor, to solicit greater competition at the subcontractor levels include:

- encouraging the primes, where economical, to "buy" rather than "make";
- avoiding "lock-ins" and "data rights situations" which may result in sole source contracts;
- encouraging primes to tailor subcontracts to reduce technical and administrative burdens;
- encouraging the primes, where appropriate, to make subcontractual arrangements which are no less favorable than those incorporated into the prime contract.

By the same token, the Government is searching for ways to remove the disincentives in procurement actions in order to encourage greater competition among prime and subcontractors. Among the efforts being pursued are:

- increasing longevity of production through multi-year authorizations and contracts;
- reducing or eliminating the specialized nature of military specifications and standards;
- accepting commercial practices and products, where feasible.

We are stressing the increased use of the multi-year contracting technique, within our authority, to provide an assurance of program stability to prospective contractors. Aside from obtaining increased levels of competition we can anticipate reduced unit prices by reason of continuity of production and elimination of repetitive start-up costs. These efforts would be greatly enhanced if Congress decided to lift the $5 million limitation on multi-year cancellation ceilings imposed by the Defense Authorization Act of FY 1973 (Public Law 92-436).

PROGRAM UNDERWAY

We have an intensive program underway to review those specifications and standards which have a potential for high cost compliance and to eliminate those requirements which contribute to this potential. We are also tailoring the actual application of those documents to the systems being produced to reflect our minimum qualitative needs. We are actively participating with recognized industry-standards organizations to promote the adoption of industry standards. To date, we have adopted almost 1,500 industry specifications and standards. We also have a very significant effort underway to increase the use of commercial, off-the-shelf products when such products adequately serve DoD's requirements. These efforts are in full consonance with the philosophy of S. 1264, the bill pending before the Senate.

While DoD has concurred in the objectives of the bill, we must likewise be cautious in mandating the use of functional specifications without considering the minimum essential characteristics a product must meet. An unlimited application of this concept would run counter to DoD's logistical support requirements and efforts at standardization as a means of cost reduction. Overly broad definitions of "functional terms" and "performance specifications" would result in widespread spare parts duplication in our inventories. For example, there are approximately 4 million numbered parts in the defense supply system. A 10 per cent duplication would result in an initial first year increase of about $146 million.

Dale W. Church

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Church is a graduate of Oregon State University where he received a B.S. degree in Business and Technology. He also holds a Juris Doctor degree from George Washington University and is a member of California and District of Columbia Bars.

Church has a wide range of experience in the field of contract policy, negotiation, administration and settlement, both in government and private industry. He has had a private legal practice with emphasis on corporate law and has been a a member of the Board of Directors of several corporations.

DEFENSE NEWS BRIEFS

Code Of Conduct Changed By Presidential Order

The Code of Conduct governing Armed Forces members when prisoners-of-war has been changed by two Executive Orders issued by the President on Nov. 3, 1977.

Article V of the Code regarding interrogation has been changed to read, in part, "I am **required** to give name, rank, service number, and date of birth."

This part previously read . . . "I am **bound** to give **only** name, rank, service number, and date of birth."

A second Executive Order established the senior ranking individual of any Armed Service (except for medical officers or chaplains) in a prison camp as the lawful superior of all lower ranking personnel, regardless of branch of Service. This amends the current Courts-Martial Manual which did not specifically delineate the senior ranking individual in a joint Service prisoner situation.

New Joint Service Medal

A new medal, the Defense Meritorious Service Medal has been created by Presidential order. It will give the Secretary of Defense a means to recognize superior performance by Armed Forces members assigned to the Office of the Secretary of Defense and other joint-Service activities when it cannot be rewarded with the Defense Superior Service Medal or the Joint Service Commendation Medal.

The new medal is comparable to the Meritorious Service Medals of the Services and completes the joint decorations inventory.

F-4s Back on Fly Status; Horn Problem Corrected

Air Force has completed inspection of the stabilizer actuator horns on 1,800 F-4 Phantom aircraft with 14 cracked or damaged horns being replaced. Mass inspection was ordered when two Phantom fighters undergoing routine inspection in October were found to have cracked horns. Following the check-out, F-4 flight restrictions were lifted.

New Attack Submarine

The nuclear powered attack submarine Birmingham (SSN 696) was christened and launched recently at Newport News, Va.

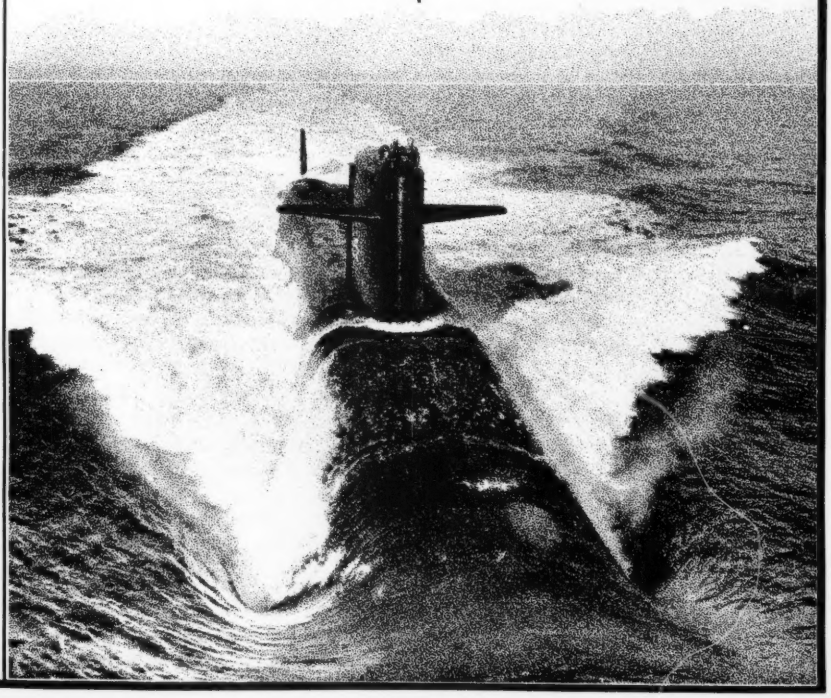
Litter Becomes Energy

DoD has installed at its Pentagon heating plant an auxilliary incinerator that burns non-pulpable paper to generate steam and hot water. It provides the building with 25 per cent of its heat and saves $200,000 annually.

Other models of the incinerator can burn garbage, and several American cities are using the system to attack two problems with one solution—getting rid of garbage and getting back heat or electric energy.

TOWs to Britain

DoD has notified Congress it proposes to sell Great Britain $41 million worth of TOW anti-tank guided missiles and TOW practice missiles.



Turning now to our efforts for better assuring adequate sources of military supplies, we have instituted a program of initiatives to deal with this subject. These include:

- issuing a directive to establish an "early warning system" for diminishing sources of materials and critical components and parts supply;
- seeking wider recognition of the potential of appropriations authorization under Title III of the Defense Production Act to remedy materials shortages and deficiencies in production capacity; and
- investigating the possibility of Government financing of dual or multiple sources of production for critical components during development (when the savings from the increased competition over the program life would pay back the initial qualification costs).

NEW POLICY

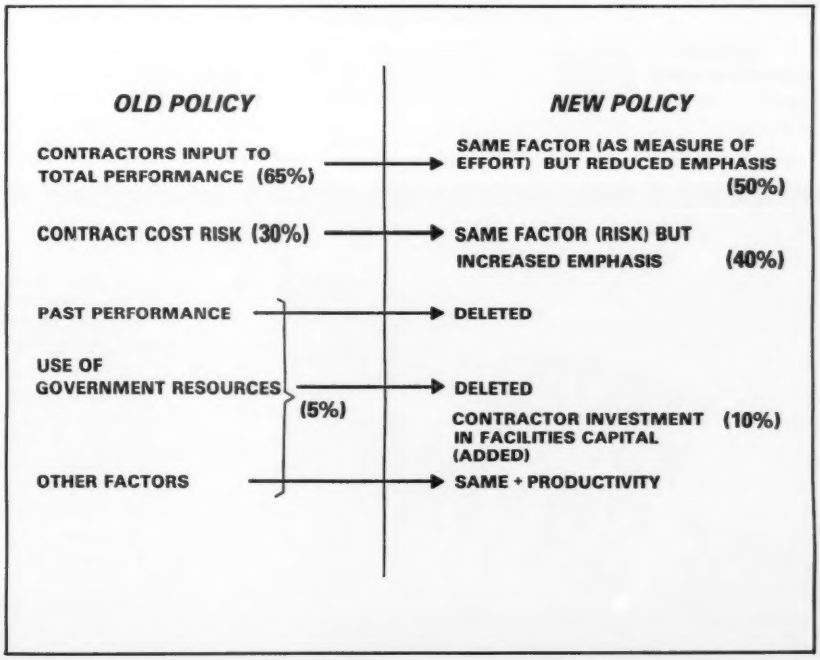
In addition to these initiatives, DoD launched a new profit policy to help strengthen the defense industrial base through the rewards of a fair level of profit. This policy is intended to recognize and reward contractor investment in cost-reducing production facilities through prenegotiation profit objectives and allowing for the imputed costs of facilities capital under Cost Accounting Standard 414. It is too early to determine the effect of this new policy on the level of investment in cost reducing facilities because of the lead time between the capital investment budgeting decision and the procurement and installation of the facilities.

We also recognized there were situations where the investment was so significant that profit motivated incentives would not provide the impetus for contractor investment. To respond to these situations, we initiated a study of investment policy to identify those factors which motivate contractor investment and the policy changes necessary to foster contractor motivation. A supporting investigation by the Logistics Management Institute revealed that defense oriented contractors reinvest at a level of about six per cent of sales while comparable commercially-oriented contractors reinvest at a level of about 17 per cent. The investment policy study concluded that the variation in investment decisions is influenced by a variety of reasons.

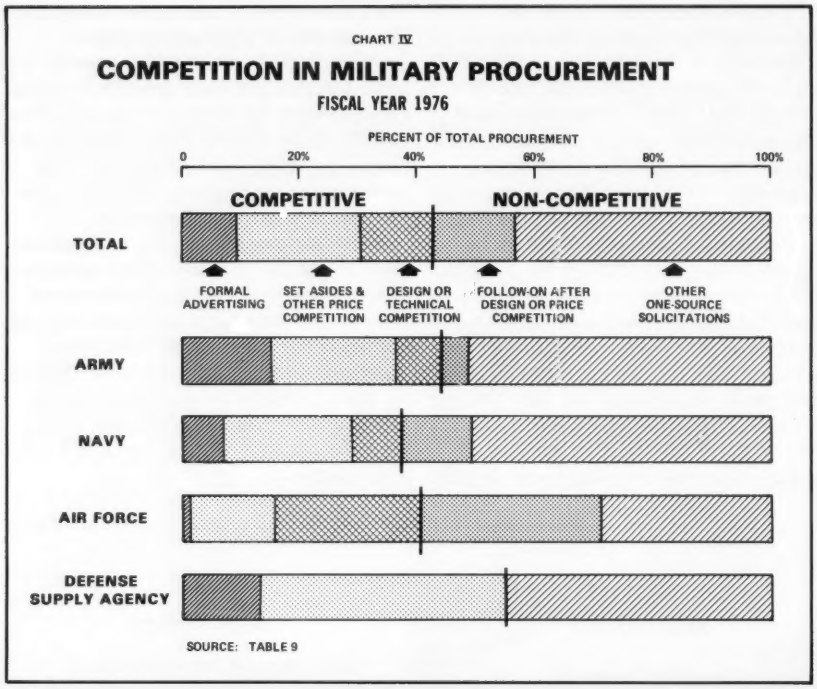
Chief among the reasons is necessity (the need to have the capability to produce competitively in order to stay in business), rate of return, cash flow, competition and the perceived risks of investment. Of these, risk in relation to return on investment and cash flow proved to be the major factor; risk in Defense procurement was perceived to be greater than in commercial business. This conclusion is based on the way the Defense Department conducts its business. Annual funding programs, program cut-backs and cancellations, schedule stretchouts, design change orders, changes due to advances in the state of the art and the lack of future business stability were singled out as being most contributory to risk in defense business.

BUY-BACK TECHNIQUE

One of the most significant new policy changes being tested as a result of the investment policy study is the special termination buyback technique. Under this technique, the economic risks associated with program instability can be reduced. In the event a procurement program is partially or wholly terminated, contractual provisions can provide for the contractor to sell specified capital investments to the Government (if he elects to do so) for their unamortized value or some portion thereof. The criteria for employing this technique is very demanding. Its use is authorized only when the investment would not be made by the contractor except to meet the requirements of the system involved and providing the contracting officer has determined that the Government will save money if the contractor makes the specific investment. Currently, the technique is being used on the F-16 and A-10 programs.



Another action we are taking to improve responsiveness and increase competition in the industrial base is through the DoD Manufacturing Technology Program. This program is designed to improve and apply manufacturing techniques, processes, materials and equipment to provide for timely, reliable and economical production of Defense materiel. We view the DoD investment in this program as "seed money", to motivate industry to "pick up the ball" and apply the new technology in the production of Defense systems. Project results substantially reduce industry's implementation risks, and furnish incentives to the private sector to implement the new technology across the entire industry spectrum. In effect, the DoD Manufacturing Technology Program shares the cost and the risk of proliferating new technology throughout industry and expanding our competitive base.



AIRCRAFT CAPACITY

The Aircraft Capacity Study has resulted in Defense actions for implementing the study's policy alternatives for reducing unused capacity. The study shows that the industry is operating at about 40 per cent of its capacity. This figure is derived by basing current industry performance on an efficient 1.4 shift, 40-hour work week. (From a nominal one-shift activity standpoint the industry is operating at 55 per cent capacity.) Government and industry analyses and market projections on which the study was based indicated that unused capacity would increase in the near term, then improve by the 1980s primarily due to an up-turn in commercial transport demand.

Estimates of the cost to the Defense Department of the unused capacity condition range between $300 and $500 million per year. For the most part, this cost consists of indirect labor, such as engineering, marketing and administrative personnel, who are retained in anticipation of and to enhance

WHAT THEY ARE SAYING . . .

"Two-thirds of all the oil ever used has been consumed in the past seventeen years. Virtually all the world's consumption of natural gas has occurred since 1945. As we compound our consumption at an annual growth rate of 3.5 percent, our reserves decline. Arguments that reserves remain to be discovered fail to take account of the numbers. To maintain even the present rate of consumption without eating into reserves, we would need to discover another Texas or Alaska every six months; or an Iran or Kuwait every three years. That is not going to happen."

—HAROLD BROWN, *Secretary of Defense, in a speech Oct. 26, 1977, before the Council for Financial Aid to Education in New York City.*

obtaining additional business. Twenty-five per cent or less of the unused capacity costs is associated with under-utilized plant and equipment.

The study furfher estimated that the realistic potential for savings resulting from reducing unused capacity was about $250 million per year while still retaining desired competition in each industry sector, that is two or three firms remaining viable to produce each type of aircraft.

The study identified eight policy alternatives as those most feasible for reducing unused capacity. These varied in complexity from ones involving Government action of a programmatic nature to those which would tend to evolve a different structural composition of the industry and a revised industry-Government relationship. We have implemented several programmatic approaches, such as endeavoring to buy aircraft at more efficient production rates with buy-outs or termination of low rate production lines, phasing development and production procurements where militarily feasible to level industry activity, and favoring facilitization and sub-contractor arrangements which would make better use of existing resources. However, these approaches are not solely DoD prerogatives. For example, Congress has not always agreed with the Defense Department on which production lines should be closed or what procurement rates, and even quantities, are needed.

In addition, DoD has directed the military departments to pay close attention during contract audits to idle facility and idle capacity costs. Idle facility costs, with some exception, are not allowed nor are those resulting from chronic idle capacity.

A proposed revision to the Armed Services Procurement Regulation (ASPR) has been developed which, when approved, will result in closer monitoring and control of contractor indirect costs. Formal procedures will be followed and a Government cost monitoring coordinator designated at locations where Government procurement is expected to exceed $50 million.

GENERIC CHECKLIST

We have constructed a generic checklist of potential capacity issues to be addressed in preparing for the Defense Systems Acquisition Review Council (DSARC) meetings at production milestone decision points. These milestone issues consist of pointed questions regarding program facilitization, use of Government properties, industrial base requirements and procurement planning aimed at establishing the most economical program.

Implementation of the more complex policy alternatives have been tabled for a number of reasons. First, the study data are basically a year old and there are indications that the unused capacity condition may be improving earlier than was projected. For example, commercial airline orders have increased and some production lines are scheduled to increase output rates next year by one-third to one-half. Secondly, the industry is apparently making voluntary corrections to reduce unused capacity in the form of disposing of unneeded facilities and lowering manpower levels. In this connection, an experimental macroeconomic model of the industry constructed during the study showed that without any change in Government policy the industry would eventually stabilize at a level of unused capacity below what we experience now. We certainly would prefer to let the free market work to the maximum degree it is able to bring about reductions in extra capacity rather than resort to increased Government manipulation or intervention.

On the subject of Government-owned production facilities, we have pursued a vigorous program to divest the DoD from plant ownership. Over the last 12 years, we have disposed of 46

"The Armed Forces account for less than two per cent of the Nation's energy consumption. The amount of fuel used in mobile operations (that is, consumption other than installation support) is about two-thirds of that two per cent, a rather modest amount. This amount goes for operations, training and other functions contributing to readiness. The Armed Forces continue to conserve energy—between FY 1974 and 1976, consumption for mobile operations has been reduced by nearly 15 per cent—but it is important to national security that the modest expenditure to support mobile operations be continued."

—GEN. GEORGE S. BROWN, *USAF, Chairman, Joint Chiefs of Staff, in a speech Nov. 10, 1977, before the Houston Club Men's Forum in Houston, Texas.*

"While a good part of our energy consumption is directly related to the maintenance of our forces, their training and their operational missions, there is also a significant part that goes into the maintenance and operation of our facilities—actually about 35 per cent of the DoD annual consumption in the Continental United States. And we recognize that we have an opportunity, indeed an obligation, to substantially reduce our energy use in these facilities through varied conservation measures."

—PERRY J. FLIAKAS, *Deputy Assistant Secretary of Defense (Installations and Housing), before the Subcommittee on Military Construction and Stockpiles, Senate Armed Services Committee, Nov. 17, 1977.*

WHO'S NEWS IN DEFENSE

Appointments

Dr. Ellen L. Frost, Department of the Treasury, has been appointed as Deputy Assistant Secretary of Defense (International Economic Affairs). Dr. Frost, who has a Ph.D. from Harvard University, also has served three years as a legislative assistant in the U.S. Senate.

Harold W. Chase took the oath of office Nov. 7, 1977, as Deputy Assistant Secretary of Defense (Reserve Affairs).

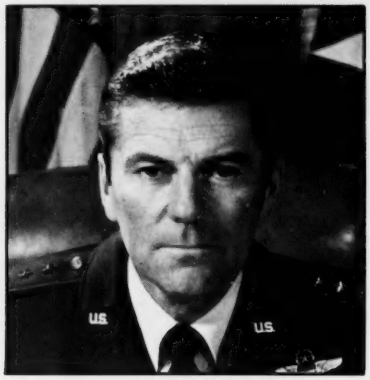
Honors

The General Thomas D. White Space Trophy was awarded to **General William J. Evans,** Commander, U.S. Air Forces in Europe. He received the honor for outstanding contributions from September 1975 to December 1976 while commander, Air Force Systems Command.

The award, named after the Air Force's fourth chief-of-staff, is presented annually by the National Geographic Society.

Takes Oath

Dr. William J. Perry was sworn in as Under Secretary of Defense for Research and Engineering during a recent Pentagon ceremony.



GEN. EVANS

Reassignments

Lt. Gen. Marvin D. Fuller, Army Inspector General, has been reassigned commanding general, III Corps and Ft. Hood, Texas.

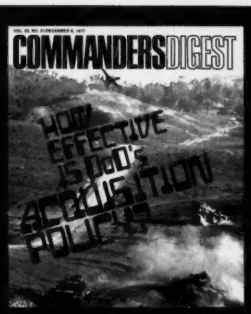
Government-owned production plants. Today, we still retain 89 such plants, of which 80 are operated by industry contractors. Our goal is to reduce the remaining 89 plants to the very minimum in line with the responsibilities and direction of the Defense Industrial Reserve Act of 1973 (P.L. 93-155).

We plan to retain 66 plants as essential to Service requirements and dispose of the remaining 23 facilities over the next five to 10 years. Over the same time period, we will continually review the 66 plant nucleus with an eye toward further reductions. Present plans for the retention and disposal of the 89 plant inventory are summarized in chart.

In summary, although we have found some problem areas in the industrial base, we find the base responsive to our procurement needs.

PLANT INVENTORY PLAN

Currently with GSA for sale to the using contractor	7
Retain as Service-designated essential contractor-operated plants	58
Retain as Service-designated essential Government-operated production plants	8
Dispose of surplus GOGO plant	1
Sell/dispose as excess to DoD requirements	5
Sub-total	79
Future efforts (during the next five to 10 years) to sell plants not designated as essential	10
TOTAL	



The acquisition of equipment is an important function in the Department of Defense.

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